

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

DOCKET FILE COPY ORIGINAL  
RECEIVED

AUG 15 1996

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

In the Matter of )  
)  
Implementation of the Non-Accounting ) CC Docket No. 96-149  
Safeguards of Sections 271 and 272 of )  
the Communications Act of 1934, as )  
amended; ( )  
)  
and )  
)  
Regulatory Treatment of LEC Provision )  
of Interexchange Services Originating )  
in the LEC's Local Exchange Area )

AMERITECH'S COMMENTS

Gary L. Philips  
John Lenahan  
John Gockley  
Steve Schulson  
Alan Baker

Counsel for Ameritech  
1401 H Street, NW  
Suite 1020  
Washington, DC 20005  
(202) 326-3817

Dated: August 15, 1996

No. of Copies rec'd  
List ABCDE

025

## TABLE OF CONTENTS

	<u>PAGE</u>
I. INTRODUCTION	2
II. BOC LONG DISTANCE AFFILIATES ARE NON-DOMINANT IN IN-REGION INTEREXCHANGE INTERLATA SERVICES (Section VIII (B)(C))	5
A. BOC Long Distance Affiliates Do Not Have the Ability to Raise Prices by Restricting Their Output (Section VIII(C))	8
B. BOCs Do Not Have the Ability to Cause Increase in the Price of InterLATA Services by Raising the Costs of Their Rivals; But Even If They Did, That Would be No Basis for Dominant Treatment of the BOC's Affiliates (Section VIII (C))	28
C. Treating BOC InterLATA Affiliates as Dominant Would be Antithetical to a Procompetitive Deregulatory National Policy Framework (VIII(C))	33
III. STRUCTURAL SAFEGUARDS UNDER CONSIDERATION GO BEYOND THE INTENT OF CONGRESS AND WOULD UNDULY LIMIT THE ABILITY OF BOCS TO COMPETE WITHOUT ANY REDEEMING ECONOMIC BENEFIT (Section IV)	37
A. The Requirement That BOC Affiliates "Operate Independently" From the BOC is Qualitative in Nature (Section IV (A))	37
B. Section 272 Only Applies to the Relationship Between Bell Operating Companies and Their Manufacturing and InterLATA Affiliates (Section IV (C-D))	39
C. Section 272 Does Not Prevent the Sharing of Administrative Services (Section IV (C))	40
D. No Further Restriction on the Sharing of Information Services is Needed (Section IV (C))	43

IV.	MARKETING PROVISIONS OF SECTIONS 271 AND 272 (Section VI)	45
A.	Section 271(g)(1) (Section VI)	45
B.	Sections 271(e) and 272(g)(2) (Section VI)	46
C.	Terms Under Which BOCs May Market and Sell the InterLATA Services of Their Affiliate. (Section VI)	50
V.	NONDISCRIMINATION SAFEGUARDS. (Section VI)	53
A.	Rules Implementing Sections 272(c)(1) and 272 (e) (Section VI (C-D))	53
B.	Transfers of Network Capabilities (Section VI (B-C))	56
VI.	ACTIVITIES SUBJECT TO SECTION 272 REQUIREMENTS (Section III)	63
VII.	ENFORCEMENT OF SECTIONS 271 AND 272 (Section VII)	72

Ameritech  
August 15, 1996

## SUMMARY

The safeguards set forth in section 272 of the Act are those that Congress deemed necessary to promote full and fair competition. They reflect a careful balancing by Congress of the perceived need to ensure that Bell Operating Company (BOC) affiliates do not have unfair advantages that could thwart competition and the simultaneous need to permit them a reasonable opportunity to participate fully and effectively in the competitive marketplace, on an even keel with existing, well-heeled competitors.

Unfortunately, Ameritech is concerned that some of the safeguards under consideration are contrary to the Act and would upset its balance by unnecessarily restricting the operations of BOC affiliates without providing offsetting public policy benefits. For example, regulating BOC long-distance affiliates as dominant would serve no valid public policy purpose; even assuming *arguendo* that BOCs could abuse bottleneck control of local exchange facilities -- which, as shown below, they could not -- regulating the BOC affiliate would in no way address the ostensible problem. At the same time, it would deny BOC affiliates the tools they need to compete effectively in the marketplace. Likewise, certain proposals for implementing the structural separation requirements go well beyond what is mandated in the Act and would impose costs that far exceed any benefits such proposals could offer. These costs of unnecessary restrictions would harm, not only the BOCs, but consumers, who would be denied both the savings generated by efficient operations and the full benefits that competition can offer.

Ameritech agrees that if regulatory restrictions are required by the Act or are necessary to prevent anticompetitive behavior they should be imposed. The Commission must recognize, however, that its goal should not be to deny the BOCs any advantages they can bring to the marketplace through economies of scope or operational or marketing efficiencies. Rather, its goal should be to address conduct that could preclude the effective functioning of the marketplace. As the Commission stated, first, in streamlining its regulation of AT&T, and then in declaring AT&T nondominant: "[T]he issue is not whether [a company] has advantages, but 'whether any such advantages are so great to preclude the effective functioning of a competitive market'. . . . [Indeed,] the competitive process itself is largely about trying to develop one's own advantages[.]"<sup>1</sup>

There is a clear reason for the Commission to take this position. The advantages a particular firm may have -- in terms of economies of scale or scope or other cost savings -- can translate into consumer benefits. Indeed, in a companion Notice of Proposed Rulemaking released on the same day as this Notice, the Commission explicitly recognized that BOC economies of scope can heighten competition and enhance consumer welfare.<sup>2</sup> By tapping into these economies, BOCs can bring real discipline to the interexchange market -- a market that many believe is in dire need of a fresh injection of competition.

---

<sup>1</sup> Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271, 3288 (1995), quoting, Competition in the Interstate, Interexchange Marketplace, 6 FCC Rcd 5880 at 5891-92 (1991).

<sup>2</sup> Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, FCC 96-309, released July 18, 1996, at para. 7.

On the other hand, regulatory shackles -- whether applied to AT&T or the BOCs -- impose costs which, ultimately, are borne by consumers. As FCC Chief Economist, Joseph Farrell has said:

Like most economists, I am uncomfortable with rules that forbid a firm from exploiting efficiencies just because its rivals cannot do likewise. Such handicapping, or leveling without regard for up or down, may make for a good game, but the game is only a metaphor. When firms are hamstrung, even in order to equalize them with other firms, consumers are liable to lose out.<sup>3</sup>

The Commission must carefully weigh these costs as it considers the proposals in this Notice.

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the Non-Accounting	)	CC Docket No. 96-149
Safeguards of Sections 271 and 272 of	)	
the Communications Act of 1934, as	)	
amended;	(	
	)	
and	)	
	)	
Regulatory Treatment of LEC Provision	)	
of Interexchange Services Originating	)	
in the LEC's Local Exchange Area	)	

---

AMERITECH'S COMMENTS

---

Ameritech hereby responds to the Commission's Notice of Proposed Rulemaking (Notice) in the above-captioned proceeding. In the Notice, the Commission seeks comment on whether it should apply dominant or nondominant carrier regulation to BOC affiliates providing in-region, interLATA services. The Commission also seeks to implement, and, where necessary, clarify the non-accounting separate affiliate and nondiscrimination safeguards prescribed by Congress in section 272 of the Telecommunications Act of 1996 (the Act or the 1996 Act). As discussed below, Ameritech urges the Commission to classify BOC in-region, interLATA affiliates as nondominant. Ameritech urges the Commission, further, to implement section 272 of the Act in a manner that is

consistent with congressional intent and that recognizes the costs of regulations that deny the BOCs operational efficiencies.

I. INTRODUCTION

The safeguards set forth in section 272 of the Act are those that Congress deemed necessary to promote full and fair competition. They reflect a careful balancing by Congress of the perceived need to ensure that Bell Operating Company (BOC) affiliates do not have unfair advantages that could thwart competition and the simultaneous need to permit them a reasonable opportunity to participate fully and effectively in the competitive marketplace, on an even keel with existing, well-heeled competitors.

Unfortunately, Ameritech is concerned that some of the safeguards under consideration are contrary to the Act and would upset its balance by unnecessarily restricting the operations of BOC affiliates without providing offsetting public policy benefits. For example, regulating BOC long-distance affiliates as dominant would serve no valid public policy purpose; even assuming arguendo that BOCs could abuse bottleneck control of local exchange facilities -- which, as shown below, they could not -- regulating the BOC affiliate would in no way address the ostensible problem. At the same time, it would deny BOC affiliates the tools they need to compete effectively in the marketplace. Likewise, certain proposals for implementing the structural separation requirements go well beyond what is mandated in the Act and would impose costs that far exceed any benefits such proposals could offer. These costs of unnecessary restrictions would harm, not only the BOCs, but consumers, who



would be denied both the savings generated by efficient operations and the full benefits that competition can offer.

Ameritech agrees that if regulatory restrictions are required by the Act or are necessary to prevent anticompetitive behavior they should be imposed. The Commission must recognize, however, that its goal should not be to deny the BOCs any advantages they can bring to the marketplace through economies of scope or operational or marketing efficiencies. Rather, its goal should be to address conduct that could preclude the effective functioning of the marketplace. As the Commission stated, first, in streamlining its regulation of AT&T, and then in declaring AT&T nondominant: "[T]he issue is not whether [a company] has advantages, but 'whether any such advantages are so great to preclude the effective functioning of a competitive market'. . . . [Indeed,] the competitive process itself is largely about trying to develop one's own advantages[.]"<sup>1</sup>

There is a clear reason for the Commission to take this position. The advantages a particular firm may have -- in terms of economies of scale or scope or other cost savings -- can translate into consumer benefits. Indeed, in a companion Notice of Proposed Rulemaking released on the same day as this Notice, the Commission explicitly recognized that BOC economies of scope can heighten competition and enhance consumer welfare.<sup>2</sup> By tapping into these economies, BOCs can bring real discipline to the interexchange market -- a market that many believe is in dire need of a fresh injection of competition.

---

<sup>1</sup> Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271, 3288 (1995), quoting, Competition in the Interstate, Interexchange Marketplace, 6 FCC Rcd 5880 at 5891-92 (1991).

<sup>2</sup> Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, FCC 96-309, released July 18, 1996, at para. 7.

On the other hand, regulatory shackles -- whether applied to AT&T or the BOCs -- impose costs which, ultimately, are borne by consumers. As FCC Chief Economist, Joseph Farrell has said:

Like most economists, I am uncomfortable with rules that forbid a firm from exploiting efficiencies just because its rivals cannot do likewise. Such handicapping, or leveling without regard for up or down, may make for a good game, but the game is only a metaphor. When firms are hamstrung, even in order to equalize them with other firms, consumers are liable to lose out.<sup>3</sup>

The Commission must carefully weigh these costs as it considers the proposals in this Notice.

---

<sup>3</sup> "Creating Local Competition," Dr. Joseph Farrell, Washington, D.C., May 15, 1996.

II. BOC LONG DISTANCE AFFILIATES ARE NON-DOMINANT IN  
IN-REGION INTEREXCHANGE INTERLATA SERVICES

Section VIII of the Notice raises the issue of whether BOC long-distance affiliates should be classified as dominant or nondominant in their provision of in-region, domestic, interstate interLATA services. Because this issue is critical to the ability of Ameritech's long-distance affiliate to compete viably as a new entrant in the marketplace against much larger, nondominant carriers, Ameritech addresses this issue first.<sup>4</sup>

The Commission has long defined dominant carriers as those with market power -- i.e., the ability to raise prices by restricting output.<sup>5</sup> The Commission observes that there are two ways in which, theoretically, a carrier profitably could raise and sustain prices above competitive levels: (1) by restricting its own output; or (2) by restricting its rivals' output through control of an essential input. The Commission asks whether a BOC or BOC affiliate could successfully engage in either type of behavior.

As discussed more fully below, there is no rational basis upon which the Commission could conclude that a BOC long-distance affiliate is dominant under

---

<sup>4</sup> Ameritech agrees with the Commission's tentative conclusion that interstate, domestic interLATA telecommunications services comprise a single product market for purposes of assessing whether BOC affiliates have market power. Ameritech also agrees that the Commission should generally continue to treat interstate, interexchange services as a single geographic market. At the same time, Ameritech understands that, notwithstanding this general rule, the Commission will inquire into whether BOC affiliates have market power in-region. Rather than attempting to dissuade the Commission from undertaking such analysis based on market definition grounds, Ameritech demonstrates herein that BOC affiliates, in fact, do not have market power in-region.

<sup>5</sup> Notice at para. 114, citing Competitive Carrier Fourth Report and Order, 95 FCC 2d 554, 558 (1983) and various other authorities.

Commission rules. As new entrants in the marketplace -- with no customers, no traffic, and no facilities outside of their local exchange serving area -- a BOC affiliate could not possibly charge supracompetitive prices by restricting its own output. As the Commission acknowledges, this would require, at a minimum, a high market share. It would also require that the incumbent carriers have limited supply capacity, that there be high entry barriers, and that the BOCs have their own interLATA transmission facilities -- none of which is the case.

Nor is there any basis upon which the Commission could conclude that BOCs could quickly confer market power on their affiliates through abuse of bottleneck control of access facilities. While the BOCs currently maintain a high market share in the local exchange services market, they have no ability to impede new entry in the marketplace, which is the defining characteristic of "bottleneck control."<sup>6</sup> The 1996 Act and the interconnection rules, issued August 8, 1996, coupled with the Commission's earlier expanded interconnection initiative and the actions of various state commissions, have eliminated, not only legal, but economic, and operational barriers to competitive entry in access and local exchange services. As a result, BOCs now face the prospect of substantial imminent competition, which restrains their ability to engage in anticompetitive conduct.

Even assuming, *arguendo*, that the BOCs maintain bottleneck control of local exchange and access facilities, they would not be able to use this control to misallocate costs, discriminate unlawfully, or engage in other anticompetitive conduct such that its affiliate would quickly gain the ability to raise price by

---

<sup>6</sup> Competitive Carrier, First Report and Order, 85 FCC 2d 1, 20-21 (1980).

restricting output. On the contrary, the extensive safeguards incorporated into the 1996 Act, combined with pre-existing statutory requirements, additional FCC safeguards, price cap regulation of BOC interstate access services, and state regulation of BOC local exchange services, will ensure that no BOC is able to abuse any vestige of market power it might retain. Certainly, given the relative positions of the BOC affiliates and incumbent carriers, such as AT&T, in the marketplace, a BOC could not possibly engage in undetected, illegal, conduct to such a degree as to quickly confer market power on its affiliate. That would require anticompetitive behavior so rampant in scope that it surely would be readily apparent to both incumbent carriers and regulators.

Nor is there any basis for classifying BOC long-distance affiliates as dominant to prevent them from restricting their rivals' output through control of an essential input. Even assuming, irrationally, that BOCs retain the ability to raise the costs of, or discriminate against, their affiliates' rivals in an anticompetitive manner, treating the affiliate as dominant would in no way address the problem. To the extent it is theorized that abuse of bottleneck control exists, the remedy lies in regulating the bottleneck; regulating an affiliated entity accomplishes nothing. Indeed, as the Commission concedes, lowering the rates of the affiliate would only increase its market share. Of course, if the affiliate ultimately acquires market power by virtue of abuse of a bottleneck, it would be appropriate for the Commission to deem the affiliate dominant at that time and regulate its charges accordingly. But the RBOC long-distance affiliates are a long way from being dominant. Indeed, it would take a cataclysmic change in the long-distance market for them to become dominant, given the head-start incumbent carriers such as AT&T have. Such a dramatic change could not possibly occur "quickly" and as a result of undetected "anticompetitive practices."

A. BOC Long-Distance Affiliates Do Not Have The Ability To Raise Prices By Restricting Their Output

In determining whether a firm can exercise market power by restricting its own output, the Commission considers: (1) market share; (2) supply and demand substitutability; (3) the cost structure, size, or resources of the firm; and (4) control of bottleneck facilities.<sup>7</sup> Ameritech addresses these factors below.

1. *Market Share*

BOC affiliates will enter the long-distance market with zero market share -- no customers, no traffic, no revenues, no presubscribed lines. They will be competing against some 500 incumbent carriers. One of these, AT&T, reported almost \$50 billion in toll revenues alone in 1995. It currently has over 100 million presubscribed lines, and its network handles over sixty billion calls annually.<sup>8</sup> Another, MCI, has 24 million presubscribed lines, and its 1995 revenues exceeded \$15 billion.<sup>9</sup> A third, Sprint, reported net long-distance revenues of over \$7 billion in 1995. It serves almost ten million presubscribed lines and claims as its customers 81% of the Fortune 500 largest United States industrial companies, as well as offshore-based multinational corporations.<sup>10</sup>

---

<sup>7</sup> Notice at para. 133.

<sup>8</sup> Long Distance Market Shares, First Quarter 1996, Industry Analysis Division, Common Carrier Bureau, FCC, July 1996 at Table 6; AT&T 1995 Annual Report at 2.

<sup>9</sup> Long Distance Market Shares, First Quarter 1996, Industry Analysis Division, Common Carrier Bureau, FCC, March 1996 at Tables 4, 6.

<sup>10</sup> Id. at Table 4. See also Sprint 1994 Annual Report at 8.

Despite this overwhelming evidence of a lack of market power, the Commission suggests that a BOC's zero market share may be of little import. It states: "Because, however, the affiliate's zero market share results from its exclusion from the market until now, it says little about whether the affiliate would quickly achieve the ability to raise price by restricting output."<sup>11</sup> The Commission does not indicate what it means by the term "quickly." Surely, however, if "quickly" means something on the order of a year or less, it is inconceivable that a BOC affiliate entering the market with zero market share -- most likely as a reseller, no less -- could bring AT&T to its knees and acquire the ability to control price by restricting its own output in that time.

Conversely, if "quickly" means some longer period of time, regulating a BOC affiliate as dominant now would be premature. For one thing, the notion that a BOC could ever acquire market power vis-a-vis AT&T is not only speculative, but remote. Moreover, regulating a BOC affiliate as dominant now in anticipation of the possibility that it might acquire market power at some point in the future is a misapplication of the Commission's Competitive Carrier regime. Under that regime, dominant firms are those with the ability to control price in the marketplace.<sup>12</sup> Those firms are regulated to prevent them from exercising their existing market power.<sup>13</sup> Dominant carrier status does not apply, and has never been applied, to firms that might acquire such ability at some unspecified

---

<sup>11</sup> Notice at para. 133.

<sup>12</sup> See Notice at para. 15: "In the Competitive Carrier Fourth Report and Order, the Commission defined market power alternatively as 'the ability to raise prices by restricting output' and as 'the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable.'"

<sup>13</sup> See Notice at para. 114: "Our rules define a dominant carrier as one that possesses market power, and a non-dominant carrier as a carrier not found to be dominant (i.e., one that does not possess market power." (Emphasis added).

point in the future. Since a finding of nondominance can always be changed if circumstances warrant, speculation about future developments is totally unnecessary.

## 2. *Supply and Demand Substitutability*

Noting its previous findings that the interstate, interexchange market is characterized by high supply and demand substitutability, the Commission states its belief that these factors will constrain the BOC affiliates' ability to raise domestic interLATA prices.<sup>14</sup> Ameritech agrees. If the excess capacity of AT&T's competitors is sufficient to constrain AT&T's exercise of market power, as the Commission has found, surely the capacity of AT&T's competitors, combined with that of AT&T, is sufficient to constrain the exercise of market power by a BOC affiliate. By the same token, if purchasing decisions of most customers of domestic interexchange services are sensitive to changes in price, a BOC affiliate would not be able to restrict output and raise prices without losing customers.

Indeed, the lack of market power of BOC affiliates is so obvious that any discussion of supply and demand substitutability is superfluous. For example, in raising the issue of demand substitutability, the Commission ignores that if long-distance consumers are not willing to switch carriers to obtain lower prices or better services, the BOC affiliates will not be able to win customers in the first place. The issue of demand-substitutability may be relevant to the question of whether a firm with high market share has market power; it is not relevant to the question of whether a new entrant has market power. Likewise, given that BOC

---

<sup>14</sup> Notice at para. 133.



affiliates do not own any transmission facilities outside their region, they lack any ability to control the market price by reducing their own output. Any reduction in output would have no effect on the availability of transmission facilities, and thus, no effect on the supply of services in the marketplace. Moreover, as the Commission acknowledges, BOC affiliates provide no output today. Whatever output they provide in the future will lead to lower prices than those that exist today.

### 3. *Cost Structure, Size, and Resources*

Ameritech also agrees with the Commission's conclusion that "the cost structure, size, and resources of the BOC affiliates are not likely to enable them to raise prices for their domestic interLATA services."<sup>15</sup> This too seems patently obvious. Each BOC affiliate will be a new entrant in the marketplace. In stark contrast, AT&T is the largest telecommunications company in the world, with 1995 total revenues of almost \$80 billion. Its revenue growth alone from 1993 to 1994 exceeded the annual revenues of 80% of the companies in the 1994 Fortune 500 listing. Certainly, if AT&T's size, resources, and cost advantages do not confer market power on AT&T, then a BOC subsidiary does not have market power by virtue of its cost structure, size, and resources.

Even ignoring the separation between the BOC and its affiliate, no RBOC even comes close in size or resources to AT&T. Ameritech's 1995 revenues, for example, were \$13.4 billion, one sixth of AT&T's. In fact, Ameritech's revenues were less even than MCI's. Significantly, MCI recently received a substantial

---

<sup>15</sup> Notice at para. 133.

capital infusion from another world class telecommunications giant, British Telecom. According to MCI, this alliance with British Telecom has "the resources, scale, and talent to become the premier global competitive force."<sup>16</sup>

Moreover, BOC affiliates do not have nationwide facilities-based networks, as do the four largest interexchange carriers. Therefore, at least initially, they will have to rely on the facilities of those carriers for their product offerings. This places them at a cost disadvantage vis-a-vis their competitors. In addition, having no customers, the BOC affiliates will be unable to take advantage of dedicated transport facilities or volume and term discounts available to larger carriers. In fact, unlike many other carriers who were protected upon entry by the equal charge per unit of traffic rule, the BOC affiliates will receive no such subsidy as they try to establish themselves in the long-distance marketplace. Under the circumstances, no credible claim can be made that the cost structure, size, or resources of BOC affiliates will enable them to control price in the marketplace.

#### 4. *Control of Bottleneck Facilities*

The fourth factor is control of bottleneck facilities. In the Notice, the Commission assumes that the BOCs control bottleneck access facilities and asks whether this control would enable a BOC affiliate quickly to achieve market power in the provision of in-region, interstate, domestic, interLATA services.<sup>17</sup> The Commission asks, in particular:

---

<sup>16</sup> MCI 1994 Annual Report at 2.

<sup>17</sup> Notice at para. 134.

whether the safeguards in the 1996 Act and any Commission rules implementing these safeguards, coupled with other provisions of the Communications Act and the Commission regulations, will sufficiently constrain a BOC's ability to improperly allocate costs, discriminate unlawfully, or engage in other anticompetitive conduct such that its affiliate would not quickly gain the ability to raise price by restricting its output of in-region, interstate, domestic, interLATA services.<sup>18</sup>

Ameritech believes that the answer to this question is clearly yes. Before addressing that issue, however, Ameritech disputes the Commission's unquestioned assumption that the BOCs maintain, and will continue to maintain, control of bottleneck access facilities.

(a) Under the Act and Commission Rules, BOCs Cannot Use "Bottleneck Facilities" to Impede New Entrants.

The Commission has defined bottleneck control as "when a firm or group of firms has sufficient command over some essential commodity or facility in its industry or trade to be able to impede new entrants."<sup>19</sup> While the BOCs' competitors are fond of chanting the mantra "bottleneck control" whenever they sense an opportunity to seek competitive advantage, in truth, any bottleneck control the BOCs once may have had has dissipated as a result of the Commission's expanded interconnection initiatives, the 1996 Act, the FCC's implementing regulations, and the actions of various states. Therefore, the Commission's unquestioned assumption that bottleneck control "to impede new

---

<sup>18</sup> Id.

<sup>19</sup> Competitive Carrier, First Report and Order 85 FCC 2d 1, 20-21 (1980).

entrants" exists and will continue to exist for some time after the BOCs receive interLATA relief is unwarranted.

As the Commission recognizes in the Interconnection Order, the 1996 Act eliminates legal barriers to local exchange competition, as well as economic and operational barriers.<sup>20</sup> Through the checklist requirements of sections 251 (which apply to incumbent LECs) and 271 (which apply to BOCs seeking long-distance authority), the Act ensures that local exchange competition will develop quickly and on a sustainable basis. Not only are the BOCs required to provide local dialing parity, number portability, access to poles, conduits, etc., but also interconnection and access to network elements at Total Element Long Run Incremental Cost (TELRIC) based rates, and resale at wholesale rates. Moreover, these requirements must be implemented before a BOC can receive in-region interLATA authority.

The requirements that LECs provide interconnection, access to network elements, and resale are particularly significant because they enable competing LECs to enter the market rapidly and with little capital investment.<sup>21</sup> Indeed, the FCC's requirement that long-distance carriers provide resale opportunities at retail rates is largely credited with eliminating barriers to entry in long-distance services. One could reasonably expect a requirement that local services be

---

<sup>20</sup> Implementation of the Local Competition Provisions in the Telecommunications Act of 1996: Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket No. 96-98, FCC 96-325, released August 8, 1996 (Interconnection Order) at paras. 10-15 (economic barriers) and 16-20 (operational barriers).

<sup>21</sup> Specifically, they enable competing LECs to enter the market without confronting the two greatest barriers to local exchange entry: (1) the substantial capital costs required to construct a local exchange network, and (2) achieving the necessary densities of traffic needed for efficient operation of that network.

available for resale at wholesale rates, coupled with the availability of interconnection, access to unbundled network elements, to have an even more pronounced effect on competition in the local exchange marketplace.<sup>22</sup> This is particularly the case in light of the large, well-financed carriers, such as AT&T, MCI, Time-Warner, MFS, and others, who have announced plans for quick, widescale entry into local exchange services.

In concluding unequivocally, and without any analysis whatsoever, that BOCs maintain bottleneck control of local access facilities, therefore, the Commission makes the very mistake it was careful not to make when it analyzed AT&T's market power: it equates market share with market power. In so doing, the Commission ignores not only its own definition of bottleneck control, but the widely accepted economic principle that high supply substitutability and low entry barriers are inconsistent with market power, even in the face of high market share.<sup>23</sup>

In fact, not only have entry barriers been eliminated, but supply capacity of BOC competitors are significant and growing rapidly. The Commission's most recent fiber deployment update reveals that competitive access providers (CAPs) had deployed 761,000 fiber miles by the end of 1995, more than triple their 1993

---

<sup>22</sup> The fact that the Commission has interpreted the Act to permit new entrants to purchase what is effectively resale under the pricing terms for unbundled elements only further reduces the costs of new entry. Now entrants can engage in a classic arbitrage: purchasing local services priced below cost under the resale terms and services priced above cost under the network element terms. Moreover, once a BOC affiliate has obtained in-region long-distance authority, the long-distance operations of the new entrant can avoid paying access charges, including the universal service subsidies for which the BOC is responsible.

<sup>23</sup> See Baumol, W.J., "Contestible Markets: An Uprising in the Theory of Industry Structure," American Economic Review, March 1982, p. 14.

deployment and almost double their 1994 deployment.<sup>24</sup> While this is still far less than the 9.4 million fiber miles reported by the BOCs, CAPs have deployed their fiber in areas where population density is greatest and usage is heaviest. This is significant because, on average, 30% of a LEC's revenues come from just one percent of its customers.<sup>25</sup> For Ameritech, business customers comprise just 10% of accounts and 33% of subscriber lines, but they generate about the same total revenues as all residential customers combined. The top 20% of Ameritech Illinois' business accounts generate 81% of business revenue; the top 2% of business accounts generate about 54% of all business revenue. Residential demand is also concentrated, if less so: The top third of residential customers account for 55% of total residential revenue and two thirds of non-local loop revenue.<sup>26</sup> Thus, even though CAPs have far less fiber than do the BOCs, they have the capacity to serve many more customers -- accounting for a far greater amount of revenue -- than their fiber capacity might otherwise suggest -- enough to constrain the BOC's pricing of access services. Indeed, considering that just three carriers -- AT&T, MCI, and Sprint -- account for more than 80% of a BOC's access minutes, BOCs face the prospect of a much more rapid loss of market share in access services than AT&T experienced in long-distance services. Under the circumstances, it is difficult to see how a BOC could sustain monopoly access prices or discriminatory access service, even if it wanted to.

---

<sup>24</sup> Fiber Deployment Update End of Year 1995, Jonathan M. Kraushaar, Industry Analysis Division, Common Carrier Bureau, FCC, July 1996 at 23, 35.

<sup>25</sup> FCC, Bypass of the Public Switched Network, Third Report and Order, released May 26, 1987 at 32. A more recent analysis found that 20% of the customers in the local exchange account for 80% of the revenues. William J. Baumol and J. Gregory Sidak, Toward Competition in Local Telephony (Cambridge, Mass.: The MIT Press, 1994) at 11.

<sup>26</sup> Testimony of Richard Kolb before the Illinois Commerce Commission, ICC Docket Nos. 93-0409 and 94-0096, pp. 11-12, Illinois Bell Exhibit 1.0 (1994).

Moreover, as competitive LECs win local exchange customers, by, for example, offering those customers integrated service packages, they will be able to avoid access charges altogether by purchasing unbundled network elements, even if they have not constructed their own local exchange facilities.<sup>27</sup> Certainly supracompetitive access pricing or a decline in the quality of BOC access services would accelerate this loss of access business.<sup>28</sup>

In the months ahead, as BOCs apply for and receive interLATA authority, potential competition will increasingly become actual competition. After relief is obtained, that trend will continue. At a minimum, the Commission glosses over a significant issue when it simply assumes that BOCs maintain bottleneck control of access service and will continue to do so as they begin providing interLATA services.

- (b) Even if BOCs Maintain Control of Bottleneck Access Facilities, They Could not Possibly Engage in Anticompetitive Conduct Such That Their Affiliate Quickly Gains the Ability to Raise Prices by Restricting Output

Even assuming, arguendo, that, for the foreseeable future, BOCs will maintain so-called bottleneck control over access facilities, a BOC could not possibly engage in cross-subsidization, discrimination, or other anticompetitive behavior that quickly confers on its affiliate the ability to raise prices by restricting output. First, statutory and regulatory safeguards – both at the

---

<sup>27</sup> Interconnection Order at paras. 328-341.

<sup>28</sup> To be sure, at least in the short-term, interexchange carriers purchasing network elements will most often use a BOC local loop, rather than another carrier's facility. But they will be able to procure that loop at cost-based rates, and, as discussed in more detail below, without any real possibility of discrimination.

federal and state levels -- would preclude this from occurring. Second, given that the BOC affiliates are starting from scratch, the notion that a BOC could engage in undetected illegal conduct to such a degree as to quickly confer market power on its affiliate defies imagination. That would require anticompetitive behavior so rampant in scope, that it surely would be readily apparent to both incumbent carriers and regulators. Third, even assuming that it were somehow possible for a BOC to drive the existing facilities-based carriers from the market through cross-subsidization or discrimination, their sunk facilities would remain available to a new entrant, most likely at fire-sale prices, thereby denying the BOC's affiliate the benefits of the BOC's illegal actions. Ameritech elaborates on these points below, turning first to cross-subsidization and then discrimination.

(i) Cross-Subsidization

As the Commission recognizes, for purposes of a market power analysis, cross-subsidization is only relevant "to the extent it enables a BOC affiliate to set retail interLATA prices at predatory levels (i.e., below the costs incurred to provide those services), drive out its interLATA competitors, and then raise and sustain retail interLATA prices significantly above competitive levels."<sup>29</sup> That is because consumer welfare is unaffected unless below-cost pricing confers the ability to raise and sustain supracompetitive pricing.<sup>30</sup>

---

<sup>29</sup> Notice at para. 135.

<sup>30</sup> See also *United States v. Western Elec. Co.*, 900 F.2d 283, 297 (D. C. Cir.), cert. denied, 498 U.S. 911 (1990): "[C]ross-subsidization is relevant under VIII(C) insofar as it may be used to price below cost in the competitive market, and thereby unfairly to acquire power and impede competition in that market."



It should go without saying that BOCs could not possibly misallocate costs on such a grand scale as to drive the incumbent carriers, including AT&T, permanently from the marketplace. For one thing, statutory and regulatory safeguards should prevent any cross-subsidization from occurring. The Commission and the courts have long recognized the efficacy of price cap regulation in reducing incentives and opportunity for cross-subsidization. As the Commission explains in the Notice, "[b]ecause price cap regulation severs the direct link between regulated costs and prices, a carrier is not able to recoup misallocated nonregulated costs by raising basic service rates, thus reducing the incentive for the BOCs to allocate nonregulated costs to regulated services."<sup>31</sup> Indeed, the Commission has recognized that even with sharing, price caps "substantially curtail[] the economic incentive to engage in cross-subsidization" and that a system of "pure" price caps, with no sharing of earnings, effectively eliminates any incentive for cost shifting."<sup>32</sup> Ameritech, in fact, operates under a pure price-cap regime, not only at the federal level, but in each of the five states in its region.

While price cap regulation ensures against any possibility that a BOC affiliate could derive market power through cross-subsidization, section 272 of the 1996 Act, coupled with the FCC's accounting rules, provide even further protection. The structural separation mandated in section 272 sharply reduces any risk of cross-subsidization by, inter alia, minimizing the amount of joint costs

---

<sup>31</sup> Notice at para. 136, citing, Computer III Remand Proceedings: Bell Operating Company Safeguards, 6 FCC Rcd 7571 at 7596 (1991). See also, United States v. Western Electric Co., 993 F.2d 1572, 1580, cert. denied, 114 S. Ct. 487 (1993): "[Price cap regulation] reduces any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling."

<sup>32</sup> Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873, 2924 (1989); Price Cap Performance Review for Local Exchange Carriers, 10 FCC Rcd 8962 (1995) at para. 187